Business Standard
Tuesday, Feb 23, 2010

Budget may lay roadmap against treaty shopping

Rajesh Bhayani / Mumbai February 23, 2010, 0:32 IST

Govt expected to empower tax dept under General Anti-Avoidance Rule

The Union Budget on Friday is expected to lay down a plan to plug loopholes in the double tax avoidance treaties which cost the Indian exchequer crores in tax revenues.

Although the implementation of the Direct Tax Code proposed by the finance ministry will be delayed, the government may initiate Code recommendations on the General Anti-Avoidance Rule (GAAR) that aims at curbing practices of tax avoidance.

Where double tax avoidance treaties provide companies with the option of paying tax in the jurisdiction that offers lower rates, GAAR prescribes that tax payers must first satisfy Indian income tax officials that there is a “genuine” commercial sense in operating from the country with which such treaties have been signed.

HAVEN HEAVENS

Country	FIIs*
British Virgin Islands	4
Cayman Islands	19
Channel Islands	8
Cyprus	3
Mauritius	83
Netherlands	35
Singapore	78

** Number of FIIs registered with Sebi*
Source: Sebi

The tax code has said “appellate authorities and courts have been placing heavy onus on revenue when dealing with matters of tax avoidance even though the relevant facts are in the exclusive knowledge of the taxpayer and he chooses not to reveal them”.

It has proposed to invoke GAAR if the main purpose of rou ing investment through a country is to get tax benefit and there is no other commercial justification in doing so.

The government’s resolve to prevent such tax avoidance was also evident from President Pratibha Patil’s address to Parliament at the start of the Budget session today. Patil said the government had already initiated steps to amend the Income-Tax Act, 1961 to enable the Centre to sign tax agreements with non-sovereign jurisdictions (or tax havens) and unearth unaccounted money parked outside India.

The President said steps had already been taken to negotiate with major countries agreements for exchange of information. Renegotiation of India’s tax treaty with Switzerland, where unaccounted money from India and other parts of the world is parked because of relatively lax banking laws there, was also underway. “India is an active part of the global efforts to facilitate exchange of tax information, and to take action against tax evasion,” she said.

Tax experts said this reform is required as “treaty shopping” has become rampant and there was an urgent need to minimise it.

The term treaty shopping is used for investments routed by companies through countries with which India has a double taxation avoidance treaty.

Mauritius is the prime example of such countries, accounting for 44 per cent of India’s foreign direct investment since 2000. But a lot of activity is also reported in places such as Cayman Island and Singapore with whom India has signed comprehensive economic cooperation agreement (including a tax treaty).

Mauritius also accounts for the highest number of foreign institutional investors (FIIs) registered with the Securities and Exchange Board of India (Sebi). While that country has 83 registered FIIs which invest in the Indian market, Singapore is the second on the list with 78 (see table).

Experts in anti-money laundering laws said that while India had some information-sharing arrangement with Mauritius and officials from that country were in regular touch with the Indian government to clarify the measures they were taking to minimise treaty shopping, others were not that forthcoming.

Experts suggested a two-way approach to halt such malpractices. Siddharth Shah, advisor funds practices, Nishith Desai & Associates, a Mumbai-based law firm said, “India needs to recognise that ‘round-tripping’ is more of an India issue than a Mauritius issue. In order to effectively deal with illegitimate ‘round tripping’, rather than blaming Mauritius or any other jurisdiction, India should look to strengthen its own exchange control regulations to discourage or penalise such round tripping of Indian monies.”

Recently, the Organisation for Economic Cooperation and Development (OECD) also suggested that India should renegotiate the treaty with Mauritius to halt practices like round tripping.

But some like Berjis Desai, Managing Partner, J Sagar Associates, said there was is no case for re-working tax treaties because countries like Mauritius had already introduced many changes to their tax laws.

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